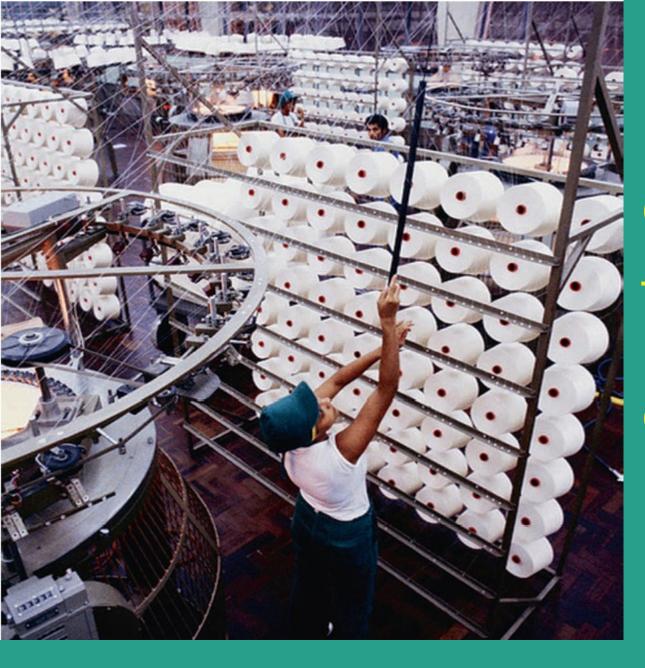
# International Business Environments and Operations, 13/e

Part 4
World Financial Environment



Chapter 10 The Determinati on of Exchange Rates

### **Chapter Objectives**

- To describe the international monetary fund and its role in the determination of exchange rates
- To discuss the major exchange-rate arrangements that countries use
- To explain how the European monetary system works and how the euro became the currency of the euro zone
- To identify the major determinants of exchange rates
- To show how managers try to forecast exchange-rate movements
- To explain how exchange rate movements influence business decisions

### **International Monetary Fund**

- Objectives of the IMF
  - To ensure stability in the international monetary system
  - To promote international monetary cooperation and exchange-rate stability
  - To facilitate the balanced growth of international trade
  - To provide resources to help members in balance-of-payments difficulties or to assist with poverty reduction

### **The Bretton Woods Agreement**

The Bretton Woods Agreement established a par value, or benchmark value, for each currency initially quoted in terms of gold and the U.S. dollar.

### The IMF Today

- The Quota System
- Assistance Programs
- Special Drawing Rights (SDRs)
  - The Global Financial Crisis and the SDR

# **Evolution to Floating Exchange Rates**

- The Smithsonian Agreement
  - 8% devaluation of the dollar
  - Revaluation of other currencies
  - Widening of exchange rate flexibility
- The Jamaica Agreement

### **Exchange Rate Arrangements**

	Exchange rate anchor				Monetary Policy Framework			
Exchange rate arrangement	US dollar	Euro	Composite	Other	Monetary aggregate target	Inflation- targeting	Other	Total
Exchange rate arrangement with no separate legal tender	7	2		1				10
Currency board arrangement	8	4		1				13
Other conventional fixed-peg arrangement	36	20	7	5	4			72
Pegged exchange rate within horizontal bands		1	2					3
Crawling peg	6		2					8
Crawling band	1		1					2
Managed floating with no pre-determined path for the exchange rate	8		3		17	10	6	44
Independently floating					1	34	5	40
Total	66	27	15	7	22	44	11	192

Source: Adapted from the International Monetary Fund, "De Facto Classification of Exchange Rate Regimes and Monetary Policy Frameworks," http://www.imf.org/external/np/mfd/er/2008/eng/0408.htm (April 30, 2008).

# Exchange Arrangements with No Separate Legal Tender

- Dollarization
- Currency Board Arrangements
- Pegged Arrangements
- More Flexible Arrangements
  - Crawling Pegs
  - Managed Float
  - Independently Floating

# **Exchange Rates: The Bottom Line**

Countries may change the exchange-rate regime they use, so managers need to monitor country policies carefully.

#### The Euro

- The European Monetary System and the European Monetary Union
- Pluses and Minuses of the Conversion to the Euro
- The Euro and Global Financial Crisis

### The Chinese Yuan

- Playing it SAFE
- The Global Financial Crisis and the Future of the CNY

### **Determining Exchange Rates**

- Non-intervention: Currency in a floating rate world
- Intervention: Currency in a fixed rate or managed floating rate world

### The Role of Central Banks

- Central Bank Reserve Assets
- How Central Banks Intervene in the Market
  - Different attitudes toward intervention
  - Challenges with intervention
  - Revisiting the BIS

#### **Black Markets**

A black market closely approximates a price based on supply and demand for a currency instead of a government controlled price.

# Foreign Exchange Convertibility and Controls

- Hard and soft currencies
- Controlling Convertibility
  - Licensing
  - Multiple Exchange Rates
  - Import Deposits
  - Quality Controls

# **Exchange Rates and Purchasing Power Parity**

- The Big Mac Index
- Short Run problems that affect PPP

# **Exchange Rates and Interest Rates**

- The Fisher Effect
- The International Fisher Effect
- Other Factors in Exchange Rate Determination
  - Confidence
  - Information

# Forecasting Exchange Rate Movements

- Fundamental and Technical Forecasting
  - Dealing with biases
  - Timing, Direction, Magnitude

# Fundamental Factors to Monitor

- Institutional Setting
- Fundamental Analyses
- Confidence Factors
- Circumstances
- Technical Analyses

# **Business Implications of Exchange Rate Changes**

- Marketing Decisions
- Production Decisions
- Financial Decisions

### Future:

- Latin America
  - Emerging market currencies should strengthen as commodity prices recover
- Europe
  - The euro is gaining popularity and will take market share away from the dollar as the prime reserve asset
- Asia
  - China is moving forward to establish the yuan as a major world currency

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